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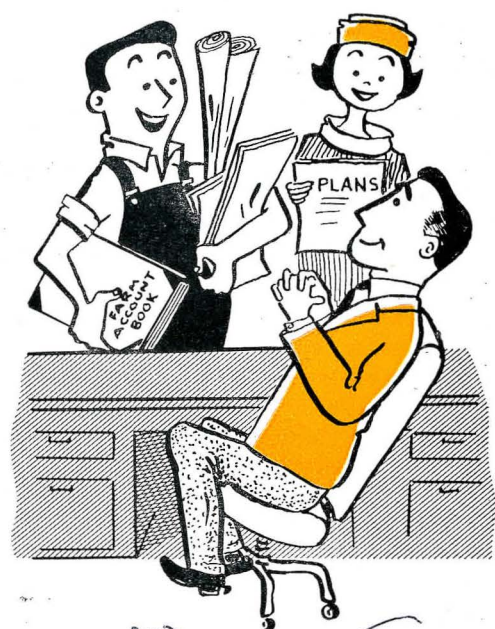
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Credit on Your Farm Or Ranch



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- SHOULD YOU BORROW?
- HOW MUCH?
- WHERE?

EXTENSION SERVICE - UNIVERSITY OF NEBRASKA
COLLEGE OF AGRICULTURE AND U. S. DEPARTMENT
OF AGRICULTURE COOPERATING W. V. Lambert, Director

Credit on Your Farm or Ranch

Credit is an important instrument in the operation of a farm. It should be used widely. Increases in efficiency and productivity frequently can be obtained through the use of credit. Capable young farmers who lack the capital to develop the productive capacity of their farms can gain from the use of more capital.

But before borrowing there are several important decisions to be made by the prospective borrower. There are many examples of wise, as well as unwise, borrowing. Credit is a two-edged instrument that can cut in either direction.

Essential Elements of a Strong Credit Program

There are several questions a prospective borrower should ask himself before he contacts a lender.

For example, will it pay to borrow? In trying to answer this question, a budget of probable income and expenditures should be worked out. By this process, costs and returns involved in the use of borrowed capital can be estimated. Do the figures show that a loan would increase the earning capacity of the farm and the family.

Other aspects also should receive attention. How great is the risk factor? Would the use of credit reduce or increase the risk factors involved in the operation of this farm?

Once these questions have been answered to the satisfaction of the borrower, then the reasoning in support of a loan request, if such is the decision, should be explained to the banker or credit agency.

The borrower should avoid divided, over-lapping, and sometimes conflicting obligations to two or more lenders. Credit agencies prefer that the borrower not be obligated to more than one source of operating capital. Lenders can serve borrowers most effectively when they do not need to guard against possible claims of other creditors.

Talk to the lender in terms of credit needs for the entire year. It is advisable that the lender see the borrower's estimate of receipts and expenses for the year. In the case of intermediate credit, a complete credit program should be set up sufficient for the entire period of the loan.

Successive requests for small loans sufficient only for short-term operation suggest lack of foresight and planning. Repeated loan applications cast reflection on the management of the borrower. The credit source may well be selected on the basis of the availability of a full line of credit from one source.

An adequate farm record of income and expenditures should be a fundamental requirement for a strong credit program. A good farm record provides information for an analysis of the farm business which will protect both the borrower and the creditor.

An adequate record also will provide information concerning the debt carrying capacity of the farm. It will reveal the quality of the management on that farm. The availability of this basic information and an analysis of it will, in most cases, determine whether a loan should be obtained at all, and if so, for what amount. Good farm record books are available at the office of the County Agricultural Agent.

Considerations in Looking for a Loan

Some of the points to consider in selecting a credit source are:

Does the lender understand farming and the factors affecting farm income?

Has the lender adapted his credit terms to the special needs of agriculture in this area.

Does the lender have a dependable source of loanable funds—one which will enable him to stay with the borrower if drought or other unavoidable cause of hardship should develop?

Does the length of the available loan fit the needs of the borrower?

Is the lender willing to set up a repayment schedule that will fit the seasonal income pattern on this farm?

Does the lender have a reputation for honesty and fairness?

The borrower should analyze carefully the cost of credit. This cost includes the interest charge and all other fees and items associated with closing the loan. What is the actual interest charge? There are several methods of applying interest charges:

(1) On some loans the interest charge is based on the unpaid balance.

(2) There are cases in which the interest charge takes the form of an annual interest rate applied to the original, or face, amount of the loan.

(3) In other cases the interest is paid in advance and the transaction is handled as a "discounted" loan.

In general, method number one is the most economical for the borrower. Each of the three methods can be illustrated. For a loan of \$2,400 to be repaid in 12 monthly payments with interest at "6 per cent," the actual interest charges in each case are as follows:

	6% Interest on the Unpaid Balance	6% on the Original Amount	6% on the Discounted Loan Basis
Interest Cost	\$ 78.00	\$ 144.00	\$ 144.00
Average Amount of Loan	1300.00	1300.00	1222.00
Actual Rate	6.0%	11.07%	11.78%

Sources of Credit

For short-term (one year or less) and intermediate term credit (two to five years) there are several sources:

(1) Commercial banks in all communities provide this kind of credit. The time required for obtaining a loan from a bank is brief, generally. Interest rates for loans of medium size vary from 5 to 8 percent. For smaller loans and those involving greater risk, the rate may be 8 percent or more. Repayment plans vary with adaptations generally obtainable to fit the income pattern of the borrower.

(2) Production credit associations, operating under the general supervision of the Farm Credit Administration, offer short and intermediate term credit to farmers and ranchers. Several days may be required for processing the loan. Interest charges range from 5 to 6 percent of the unpaid balance, with the specific rate depending on the cost of money to the association and the cost of operating the business.

(3) The Farmers Home Administration, with money appropriated by the Federal Government, extends credit to borrowers who are not eligible to borrow elsewhere. Considerable time may be required for processing the loan. Loans of the following kinds are made available by the FHA:

Production and subsistence loans for the purchase of livestock, feed, seed, and equipment; soil and water conservation loans; special loans offered as emergency credit to established producers who, temporarily at least, are unable to obtain credit elsewhere. These emergency loans may be used for normal farm operating expenses but not for paying existing debts.

(4) Merchants and retail dealers extend credit to customers on "open" accounts. The user of this kind of credit should make inquiry about interest or carrying charges.

(5) There are individuals with money to lend. For these loans there is no single policy, either in interest charges or repayment requirements. Terms vary widely. This can be one of the most, or one of the least, favorable sources of credit.

Long term loans are available from several sources also:

(1) Local banks make real estate loans, either directly or as representatives of insurance companies and other lenders.

(2) National farm loan associations, operating under the general direction of the Farm Credit Administration, specialize in long term farm real estate loans. These associations are organized by districts, with several counties included in a district. The interest rate is $4\frac{1}{2}$ to 5%, and loans are made for 5 to 40 years.

The amount of money available may be any amount up to 65 percent of the appraised normal agricultural value of the real estate with a maximum of \$200,000. Repayment is on a semiannual

or annual basis. In addition to payments made directly on the loan, there is provision for the accumulation of a "future payment fund" which is in the nature of a reserve account into which payments over and above required amounts may be made by the borrower in good years. The borrower may draw on this fund in low-income years to meet the payment schedule in the event he runs into an emergency situation.

(3) The Farmers Home Administration offers two kinds of long-term credit to borrowers who cannot obtain credit from other sources. One kind, referred to as "direct loans from FHA," may be made in amounts up to 100% of the certified value of the collateral. The second kind of credit, which is an insured loan made from funds provided by some other lender, is made in amounts up to 90% of the certified value. These loans may be made for farm purchase or for improvements on real estate already owned by the borrower.

(4) Long term loans are available also from individual lenders who have savings which they are willing to lend on real estate, in return for which a mortgage on the farm is required. Terms of the loan generally are decided by mutual agreement.

In general, productive and economical use of credit requires careful study. The application of business principles and sound judgment is exceedingly important. The use of credit can help, or it can hurt the user, depending on the soundness of the policy and the manner in which it is carried out.

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This Circular is a publication of the **Drought Committee of the Nebraska College of Agriculture**. It was prepared by Norris J. Anderson, Eldon Erickson, Philip A. Henderson, and Everett E. Peterson, Extension Economists of the University of Nebraska.